IN THE

Supreme Court of the United States

October Term, A.D. 1942.

No. 512

STANDARD OIL COMPANY (INDIANA), *Petitioner,*

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

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INDEX.

LIST OF AUTHORITIES CITED.

MISCELLANEOUS.

REVENUE ACTS.

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To the Honorable Chief Justice and Associate Justices of the Supreme Court of the United States.

The petitioner prays that a writ of certiorari issue to review the judgment of the Circuit Court of Appeals for the Seventh Circuit entered in the above cause on June 12, 1942.

OPINIONS BELOW.

The opinion of the United States Board of Tax Appeals (R. 319-361) is reported in 43 B. T. A. 973. The opinion of the Circuit Court of Appeals (R. 391-408) is reported in 129 F. (2d) 363.

JURISDICTION.

The judgment of the Circuit Court of Appeals was entered June 12, 1942. (R. 408). The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED.

During the year 1930 petitioner's affiliate, the Stanolind Crude Oil Purchasing Company (known as the Sinclair Crude Oil Purchasing Company prior to September 22, 1930, and hereinafter referred to as "Stanolind") paid to the United States of America the sum of $2,906,484.32 including interest of $908,893.06. Said amount represented a judgment entered in a trover action against Stanolind in favor of the United States during said year. Stanolind, by virtue of the said payment acquired a cause of action against another corporation and was able to collect $4,618.86 on the said cause of action. The balance of said payment, $2,901,865.46, was not recoverable from any source and therefore represented a complete loss in the sense of a diminution of assets.

The question presented herein is whether or not the said balance of $2,901,865.46, or any part thereof, may be deducted in computing the consolidated net income of petitioner and affiliates for said year.

STATUTE AND REGULATIONS INVOLVED.

The pertinent statutory provisions and regulations herein involved are contained in the Appendix.

SUMMARY STATEMENT OF THE MATTER HEREIN INVOLVED.

Stanolind was incorporated on February 5, 1921. (R. 129, 326.) Its sole stockholders from date of incorporation to September 22, 1930 were the Sinclair Consolidated Oil Company, hereinafter sometimes referred to as "Sinclair" and

petitioner, each of which owned 50 per cent of the stock, and each of which, pursuant to an agreement between them, named one-half of the Board of Directors of Stanolind. (R. 129, 326). On September 22, 1930 petitioner purchased the one-half interest belonging to Sinclair and thereupon became the sole owner thereof. (R. 129, 326).

The Mammoth Oil Company (sometimes hereinafter referred to as "Mammoth") was incorporated on February 28, 1922.

On October 24, 1922, Stanolind entered into a contract with the Midwest Refining Company (another subsidiary of petitioner, and hereinafter sometimes referred to as "Midwest") and Mammoth, whereby each of the two latter companies agreed to sell to Stanolind at prevailing posted prices Wyoming crude oil "to an amount not exceeding thirty million barrels". (R. 130, 327-330.) Each of the sellers also guaranteed title and agreed to hold Stanolind harmless.

This contract was performed by the parties until March 12, 1924 when receivers were appointed for Mammoth in an equity suit brought in the United States District Court for the District of Wyoming, hereinafter for convenience sometimes referred to as the "Wyoming suit" or "Wyoming case". Up to that time Mammoth had sold Stanolind 1,430,024.70 barrels of crude oil for which Stanolind paid Mammoth an aggregate of $2,167,591.26. (R. 130.)

In its returns for the years prior to 1928, Stanolind duly reported all of the income realized by it from the sale of the said crude oil and no part thereof has ever been eliminated from its taxable income. (R. 130-131.)

In December, 1928, the United States brought an action of "trespass on the case in trover" against Stanolind in the United States District Court for the District of Delaware, hereinafter sometimes referred to as the Delaware case or suit, for the conversion of the said 1,430,024.70 barrels of crude oil. (R. 133-134, 226-236, 336-339).

The declaration filed in said Delaware suit contained three counts. The first count claimed, exclusive of interest, the value of the oil as of the alleged dates of conversion (substantially the same as the amount which Stanolind had paid Mammoth). (R. 227, 330, 338.) The second and third counts claimed, exclusive of interest, not only the value of the oil as of the dates of the alleged conversion, but also exemplary and punitive damages on the grounds that Stanolind had acquired the oil with full knowledge of Mammoth's fraud in obtaining it, and had with said knowledge, "wrongfully, willfully, unlawfully and fraudulently converted and manufactured the said crude oil into fuel oil and other refined petroleum products and thereby increased the value thereof by the sum of $1,000,000". (R. 230, 338.)

In the latter part of 1929, Stanolind (after answer, replication and demurrer had been filed) offered to terminate the Delaware suit by paying to the United States the sum of $2,167,591.26, the value of the oil as represented by the prices which Stanolind had paid Mammoth as aforesaid, less the sum of $170,000, the estimated value of seventeen oil storage tanks on the Teapot Dome lease belonging to Stanolind, with interest computed on both at the rate of 7 per cent per annum (the legal rate in Wyoming). (R. 134, 251, 252, 339, 341). Counsel for the United States in said action, the Honorable Owen J. Roberts and the Honorable Atlee Pomerene, recommended the acceptance of the proposed offer in a letter to Senator Thomas J. Walsh dated April 3, 1930. The following statements are quoted from the said letter: (R. 251, 253, 340, 341, 342.)

> "* * * This suit was for the conversion of the oil by the Sinclair Crude Oil Purchasing Co. based upon the theory that as the Mammoth Oil Co. had never acquired a valid title to the leasehold it could not give good title to the oil taken therefrom.
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> * * * * * * * * * *
>
> "* * * As the proposition was substantially for the full amount which the Government could recover, it

was thought wise to accept it and close the litigation. * * *

* * * * * * * * * *

"The Sinclair Crude Oil Purchasing Co. we think properly takes the position that we as special counsel have no authority to settle this case or to satisfy any judgment which may be taken by agreement in the case without a resolution of Congress authorizing us so to do. * * *

* * * * * * * * * *

"As we have heretofore advised, we consider this a very advantageous settlement to the Government. * * *

* * * * * * * * * *

"Under the proposed arrangement the Government is, we think, getting as favorable a result as it could get by pursuing the litigation to judgment and execution."

On April 14, 1930 the Committee on Public Lands and Surveys of the United States Senate recommended the passage of a joint resolution authorizing the said settlement on the aforesaid basis, (R. 134, 251, 343) and Congress approved the agreement by a joint resolution. (R. 135, 343.)

On May 28, 1930 the parties filed a stipulation in the Delaware case which included the following: (R. 135, 255, 344)

"* * * *that the fair amount due to the plaintiff in the above entitled action is the sum of $2,906,484.32* * * *".

Pursuant to said stipulation, judgment for $2,906,484.32 was entered on May 28, 1930 and paid on June 2, 1930. (R. 135, 344.) *Said judgment represented principal in the amount of $1,997,591.26, and interest in the amount of $908,893.06.* (R. 134, 135, 249, 340.) At the time of said judgment, Stanolind owed Mammoth $4,618.86. Except for said liability, Stanolind's claim against Mammoth, which arose by reason of said payment to the United States, was worthless and unrecoverable. (R. 135, 330, 345.) The balance of said claim in the amount of $2,901,865.46 was charged off on Stanolind's books.

In its separate return for the period January 1 to September 21, 1930 Stanolind reported a net loss which included a deduction for said amount of $2,901,865.46. (R. 345.)

In the return filed by petitioner for itself and affiliates (including Stanolind) for the year 1930, said net loss was taken as a deduction in computing the consolidated net income of the said group. (R. 345.)

In a deficiency notice to petitioner for the calendar year 1930, the Commissioner disallowed the said deduction of $2,901,865.46 on the ground that it was a voluntary payment. (R. 29, 352.) Said disallowance was sustained by the Board of Tax Appeals on the ground of "public policy". (R. 354-361.)

On appeal to the United States Circuit Court of Appeals for the Seventh Circuit, the said Court affirmed the Board and held that the asserted deduction was barred on grounds of public policy. (R. 391-408.) The said Circuit Court of Appeals also rejected petitioner's claim for increased depreciation covering certain patents, which issue is not pressed in this petition.

SPECIFICATION OF ERRORS TO BE URGED.[1]

1. The Circuit Court of Appeals erred in affirming the order of the Board of Tax Appeals, and in failing and refusing to hold that the amount of the payment, or any part thereof, which Stanolind made to the United States during the year 1930, as aforesaid, be allowed as a deduction, in computing Stanolind's net loss, and in turn, the consolidated taxable net income of the group for the said year.

2. The Circuit Court of Appeals erred in disallowing the deduction of said payment either as a bad debt, an ordinary and necessary business expense, or as a loss.

3. The Circuit Court of Appeals erred in holding that the deduction sought was precluded on grounds of public policy.

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[1] The Court's attention is particularly invited in this connection to the petition for rehearing of the lower court's decision. (R. 410-418.)

4. The Circuit Court of Appeals erred in disallowing that portion of the said payment representing the payment of interest.

5. The Circuit Court of Appeals erred in accepting a so-called "finding of fact" by the Board of Tax Appeals that Stanolind acted in bad faith and as a *mala fide* trespasser upon Government lands in acquiring the oil in question, said "finding" having been based solely upon a conclusion of law that the Wyoming decree was *res judicata* in this case.

6. The Circuit Court of Appeals erred in holding, in effect, that the Wyoming suit was *res judicata* of this case and in failing and refusing to hold the Delaware judgment to be solely *res judicata.*

7. The Circuit Court of Appeals erred in failing to adopt the same interpretation of the record, *including this Court's opinion,* in the Wyoming case as that adopted by the Congress and counsel for the United States in the settlement of the Delaware case.

8. The Circuit Court of Appeals erred in deciding the question herein presented on the basis of assumed facts not of record.

9. The Circuit Court of Appeals erred in holding Stanolind to be in *pari delicto* with Mammoth in an alleged illegal transaction.

10. The Circuit Court of Appeals erred in holding that the said payment made by Stanolind constituted damages arising from a fraudulent transaction allegedly perpetrated upon the United States.

11. The Circuit Court of Appeals erred in holding that a judgment for damages arising out of a tort against the United States is, for tax purposes, distinguishable from cases where the damages arise out of a tort against a private citizen.

REASONS FOR ALLOWANCE OF WRIT.

1. The question involved is one of general importance.

The Court below recognized the unique and unusual character of the issue involved. (R. 401.) The decision, therefore, as a precursor excites a query of gravity and general importance in the administration of the Federal revenue laws which should be reviewed by this Court. In its broader aspects, the question here concerns the power of administrative officials to make sweeping denials of tax deductions expressly granted by the Statute on the ground alone that they are "against public policy".

This case involves the deductibility of an amount representing a payment made to the United States in satisfaction of a judgment entered in a trover action. A substantial portion of said payment represented interest.

The applicable revenue act allows deductions from gross income of (1) losses sustained during the taxable year; (2) ordinary and necessary expenses paid or incurred during the taxable year; (3) debts ascertained to be worthless and charged off within the taxable year; and (4) interest paid or accrued within the taxable year on indebtedness. (See Appendix.)

The regulations promulgated under the applicable Revenue Act allowed as a deduction: (Art. 342 of Reg. 74) "judgments or other binding adjudications * * *". (See Appendix.) This regulation was applied by the Commissioner in similar situations in *S. M. 4078*, C. B. V-1, p. 226 (1926); *I. T. 1853*, C. B. II-2, p. 124 (1923); and by the Courts and the United States Board of Tax Appeals[1] in *Helvering* v. *Hampton* (C. C. A. 9), 79 F. (2d) 358; *International Shoe Co.*, 38 B. T. A. 81; *W. R. Hervey*, 25 B. T. A. 1282; *Charles R. Stuart*, 38 B. T. A. 1147; *North American Investment Co.*, 24 B. T. A. 419, and *Shiman* v. *Commissioner* (C. C. A. 2), 60 F. (2d) 65.

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[1] Now called "The Tax Court of the United States," Sec. 504, Revenue Act of 1942.

This Court has applied the doctrine of public policy in tax cases in only one instance, *Textile Mills Securities Corp.* v. *Commissioner,* 314 U. S. 326. That case involved a deduction claimed for lobbying expenses. The regulations had since 1915 expressly disallowed such deductions, and this Court simply approved the Regulations.

Examination of the so-called public policy cases decided by other Federal Courts and the Board of Tax Appeals (other than the lobbying expense cases) reveals that they involved, (1) fines or penalties incurred as a result of statutory violations; (2) legal expenses in defending criminal prosecutions, or (3) commercial bribery or similar offenses. *Great Northern R. Co.* v. *Commr.,* 40 F. (2d) 372, 373, cert. den. 282 U. S. 855; *Burroughs Bldg. Material Co.* v. *Commr.,* 47 F. (2d) 178, 179, 180; *Helvering* v. *Hampton* (C. C. A. 9), 79 F. (2d) 358, 359, 360; *Chicago, R. I. and P. Ry. Co.* v. *Commr.,* 47 F. (2d) 990, 991; *Tunnel R. R. of St. Louis* v. *Commr.* (C. C. A. 8), 61 F. (2d) 166, 173; *W. R. Hervey,* 25 B. T. A. 1282, 1290, 1291; *S. M. 4078* (1926), C. B. V-1, p. 226; *Easton Tractor & Equipment Co.,* 35 B. T. A. 189; *T. G. Nicholson,* 38 B. T. A. 190; *Frank A. Maddas,* 40 B. T. A. 572.

In all of the above cases, the doctrine of public policy was used as an aid in interpreting the statute and not as justification for refusing to apply the Statute and regulations. In this case the Court disallowed a deduction for a judgment in an ordinary tort action—in spite of the fact that it falls within the express language of the Statute and regulations.

It is submitted that the attempt of the Commissioner to apply the doctrine of public policy in this case contrary to the regulations and to read into the Statute a provision which is not there, is beyond his power, and the approval of the Commissioner's action by the Board and the Circuit Court of Appeals should be reviewed by this Court.

The scope of the doctrine of public policy and the extent to which it can be applied in tax cases should be clearly de-

fined. It should not be left to the discretion of the Commissioner of Internal Revenue to determine whether, and to what extent, if any, he can ignore the express provisions of the Statute on the grounds of public policy.

2. As applied to the stipulated facts in this case, as distinguished from the facts erroneously assumed by the court, the judgment of the court below clearly involves a new and unique question which should be considered by this court.

The expenditure herein involved constituted the payment of the judgment in the Delaware suit, a Court action involving no criminal aspects whatsoever. *That suit was for the conversion of the oil by Stanolind based upon the theory that as Mammoth had never acquired a valid title to the leasehold it could not give good title to the oil taken therefrom.* Stanolind was in the business of buying and selling oil, and the oil in question represented less than 3 per cent of Stanolind's total purchases of oil for the period in question.

In the first count, the United States claimed merely the value of the oil as of the dates of the alleged conversion. In the second and third counts, it claimed "exemplary" or "punitive" damages in the amount of $1,000,000. Such damages may only be recovered where the conversion is willful or intentional. *Scott* v. *Donald*, 165 U. S. 58; *United States* v. *Ute Coal & Coke Co.* (C. C. A. 8), 158 F. 20; *Trustees Dartmouth College* v. *International Paper Co.*, 132 F. 92; *Armstrong* v. *Rhoades*, 20 Del. 151, 53 A. 435; *Hendle* v. *Geiler* (Del.), 50 A. 632; *Hall Oil Co.* v. *Barquin*, 33 Wyo. 92, 237 P. 255.

The Delaware case was settled by the acceptance of Stanolind's offer to pay for *the value of the oil, the amount claimed in the first count, less a credit for the value of Stan-*

olind's tanks on the Mammoth lease. Both the Congress (which approved the settlement)[1] and counsel for the United States, who had represented the Government in both the Wyoming and Delaware cases, emphasized the fact that the proposition was substantially for the full amount which the Government could have recovered had it pursued "the litigation to judgment and execution". (R. 253, 342.)

The claims for "exemplary" or "punitive" damages demanded in the second and third counts of the plaintiff's declaration in the Delaware suit, were abandoned by the United States. They could have been sustained if bad faith or *mala fides* in the purchase of the oil had already been adjudicated as claimed by the Board and the Circuit Court. *Day* v. *Woodworth et al.*, 54 U. S. 363, 371, 14 L. ed. 181, 185; *Scott* v. *Donald*, 165 U. S. 58, 88, 41 L. ed. 632, 637; *United States* v. *Ute Coal & Coke Co.* (C. C. A. 8), 158 F. 20, 23; *Armstrong* v. *Rhoades*, 20 Del. 151, 53 A. 435; *Hendle* v. *Geiler* (Del.), 50 A. 632, 633.

The absence of any fraud or bad faith on the part of Stanolind was further established by the express allowance for the storage tanks. An improver who has not acted in good faith cannot recover for his improvements. Such recovery is denied on the ground of public policy. Woodward, *"The Law of Quasi Contracts"* (1913), Sec. 135; *Casper Nat. Bank* v. *Swenson et al.*, 42 Wyo. 113, 291 P. 812, 817; *Kentucky River Coal Corp.* v. *Combs*, 269 Ky. 365, 107 S. W. (2d) 241, 245.

Counsel for the United States in their letter to Congress, in the full observance of their public trust, recognized that exemplary or punitive damages could not be recovered, further that Stanolind was affirmatively entitled to the value of the storage tanks.

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[1] This approval of the settlement by Congress in the light of the existing statute allowing deductions on account of payments in satisfaction of judgments in tort actions, coupled with the Commissioner's rulings and regulations, fixed the public policy of this case. The approval was without reservation that the amount paid would not be deductible for tax purposes.

The judgment by stipulation (in trover) in the Delaware case, therefore, represented a definite determination of issues between the parties—(1) that Stanolind was liable for the value of the oil and the United States was entitled to no more, and (2) that Stanolind was entitled to reimbursement (by way of an equitable offset at least) for the amount by which the United States had been unjustly enriched by the retention of Stanolind's tanks, a clear recognition that they had been acquired and erected by Stanolind in good faith. The judgment was not a compromise in the ordinary sense of a lump sum settlement to avoid further litigation. It was meticulously computed upon the basis of the issues conceded, and the definite liabilities fixed, by the agreement of the parties.

The judgment was, therefore, *res judicata* of, and conclusively determines, the character of the payment herein involved for tax purposes. *United States* v. *Parker,* 120 U. S. 89, 30 L. ed. 601, 604; *Bullard* v. *Commr.* (C. C. A. 7), 90 F. (2d) 144, 147; *O'Cedar Corporation* v. *F. W. Woolworth Co.* (C. C. A. 7), 66 F. (2d) 363, 366; *Pick Mfg. Co.* v. *General Motors Corporation* (C. C. A. 7), 80 F. (2d) 639, 641; *Rector* v. *Suncrest Lumber Co.* (C. C. A. 4), 52 F. (2d) 946, 948; *Warner* v. *Tennessee Products Corporation* (C. C. A. 6), 57 F. (2d) 642, 643; *Cass County* v. *Rambo,* 131 S. W. (2d) 214, 216; *Safe-Deposit & Trust Co.* v. *Wright* (C. C. A. 3), 105 F. 155, 158; *Hot Springs Coal Co.* v. *Miller* (C. C. A. 10), 107 F. (2d) 677, 681; *Pittsburgh P. Glass Co.* v. *National Labor Rel. Bd.,* 313 U. S. 146, 159, 85 L. ed. 1251, 1262; *Jackson* v. *Irving Trust Co.,* 311 U. S. 494, 85 L. ed. 297, 302; *Snell* v. *J. C. Turner Lumber Co.,* 285 F. 356, 358. As the payment of a judgment in an ordinary trover action, it is deductible under the Statute, the regulations, and the decided cases. This should be particularly true where the disposition of the action actually negatived the existence of fraud or bad faith on the part of the defendant.

This was petitioner's contention before the Board of Tax Appeals and before the Circuit Court of Appeals below,

notwithstanding the Circuit Court's observation that "Petitioner's chief reliance is based on the proposition that neither of the former adjudications in the Wyoming or Delaware cases is *res judicata* of its *mala fides* or fraudulent intent because this is a different and distinct proceeding, a proceeding to assess an income tax". (See petition for rehearing, R. 410.)

We respectfully submit that the proposed application of the so-called public policy doctrine to the stipulated facts in this case, which—from the foregoing review—clearly do not involve (1) any criminal aspects, (2) actual bad faith or *mala fides*, or (3) statutory violations, involves an important new and unique question which should be considered by this Court—particularly—when the application of such doctrine in this case results in the disallowance of a deduction expressly allowed by the statute and regulations.

3. This case involves a conflict in the interpretation of the record, including this court's opinion, in the case of Mammoth Oil Co. v. U. S., 275 U. S. 13.

The Court below accepted a so-called finding of fact by the Board that Stanolind acted in bad faith and as a *mala fide* trespasser upon Government-owned lands in acquiring the oil in question. (R. 405.) This finding is bottomed upon the following conclusion of law by the Board: (R. 355, 356, 358).

> "Stanolind's good or bad faith in its transactions with Mammoth is now an issue of fact in the instant proceedings. That issue having been litigated and adjudicated in the Wyoming suit, and the record in that case having been offered and received in evidence in the instant proceedings, the judgment of the Supreme Court determining that issue is conclusive here."

This said "finding" was not, and could not be, predicated upon independent proof of record because in that respect

the record is wholly deficient.[1] This Court should, therefore, review the record because the Board's decision, and in turn that of the Circuit Court of Appeals, was based upon an erroneous conclusion of law. *Helvering* v. *Rankin,* 295 U. S. 123, 79 L. ed. 1343.

The sole issue in the Wyoming suit with respect to Stanolind was whether Stanolind had a right to use or remove its storage tanks on the lease (not whether Stanolind was entitled to compensation as an innocent improver). This is clear from the following quotation from this Court's opinion in that case: (R. 335)

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[1] This is substantiated by examination of the evidence offered at the hearing before the Board. Such proof consisted solely of (a) recitations in a stipulation of facts, signed by counsel for the Commissioner and petitioner herein, to which were attached copies of certain pleadings, orders, mandates, and decrees in the said Wyoming suit. (R. 124-137, 141-226); (b) transcripts of arguments made in the Wyoming District Court (R. 267, 270-284); (c) Stanolind's brief in the Circuit Court of Appeals in said case (R. 267, 310-318); (d) briefs filed by Stanolind and Sinclair Pipe Line Company in this Court (R. 267, 285-309); and (e)opinions in said case by the District Court, the Circuit Court of Appeals and the Supreme Court of the United States. (R. 268.)

The said stipulation of facts recited that the references therein contained to the attached pleadings, orders, mandates, decrees, etc., in the said Wyoming case should not be construed as a concession on the part of petitioner that any fact found by said courts or any of them, should be considered as a fact in this case, except and to the extent, that it was set out in the stipulation itself, or that the decisions of said courts was *res judicata* of any issue of fact or law involved in this case.

The offer in evidence of the aforementioned oral arguments in the District Court and briefs in the Circuit Court of Appeals and the Supreme Court were by agreement limited strictly to whatever bearing they might have on the identification of the issues involved in the Wyoming case, and they were received by the Board Member, subject to such limitation. (R. 266, 268.) The aforementioned opinions in the Wyoming case were specifically offered in evidence by the Commissioner "for the limited purpose of identifying the issues". (R. 268.) No independent evidence of the facts relied upon in that case was offered in this case. The so-called facts relied upon by the Board and approved by the lower Court were not adjudicated in the Wyoming case.

"The lease gave the Mammoth Company the right to construct tanks and other operating facilities on the reserve. In January, 1923, the petitioner, Sinclair Crude Oil Purchasing Company, bought from that company the tanks already constructed and others being built thereon. It used them to store Salt Creek royalty oil that it bought from the government. *It claims that it relied on the validity of the lease and became the owner of the tanks as licensee and grantee of the lessee and entitled to maintain them in all respects* as the lessee was entitled to do under the lease. It contends that the circuit court of appeals erred in directing it to be restrained from further trespassing upon the reserve, and *that in any event it should be given opportunity to remove its property.* But the Purchasing Company is presumed to have known that no law authorized the making of any such lease. The existence of that arrangement for the exhaustion of the reserve was calculated to excite the apprehensions of one considering such a purchase and put him on his guard rather than to give assurance of safety. The use of such tanks to take oil from the reserve was a part of the illegal scheme. Moreover, the Purchasing Company was owned half and half by the Sinclair Consolidated Oil Corporation and the Standard Oil Company of Indiana. Sinclair was chairman of the board of the former, and Stewart held like position in the latter. Shortly before the Purchasing Company bought the tanks, these chairmen acted for and controlled it in respect of most important transactions. That and other disclosed circumstances are sufficient to *impute* to it Sinclair's knowledge of the conspiracy to defraud by which the lease was obtained. *It is clear that, in respect of the use and removal* of these tanks, the Purchasing Company is in no better position than the Mammoth Company would have occupied, if it owned them". (Italics ours.)[1]

We submit, therefore, that the Wyoming case involved, as to Stanolind, no issues with respect to the oil in question,

[1] The Circuit Court of Appeals for the Eighth Circuit erroneously assumed that Stanolind was claiming compensation for, as well as the right to use or remove, the tanks. (R. 294, 295.) Hence, its comments are dictum and in no way controlling.

hence, it cannot be *res judicata* of any fact bearing thereon in the instant case. *Vicksburg* v. *Henson,* 231 U. S. 259, 269, 270, 273, 58 L. ed. 209, 216, 218; *Cromwell* v. *Sac County,* 94 U. S. 351, 24 L. ed. 195, 199, 200; *North Carolina R. Co.* v. *Story,* 268 U. S. 288, 293, 294, 69 L. ed. 959, 962; *Oklahoma* v. *Texas,* 272 U. S. 21, 42, 43, 71 L. ed. 145, 154; *Troxell* v. *Delaware L. & W. R. Co.,* 227 U. S. 434, 441, 442, 57 L. ed. 586, 590; *Mendez* v. *Bowie,* 118 F. (2d) 435, 441. This was admitted by counsel for the United States in both the Wyoming and Delaware suits when they alleged in the Delaware suit: (R. 243, 339).

> "* * * the cause of action in said Wyoming suit is separate and distinct from the cause of action in the above-entitled case * * *".

We believe this Court simply decided that Stanolind had failed to prove (1) that Mammoth had acquired valid title to the tanks which it gave to Stanolind, and (2) that as a purchaser for value, it was not charged, as against the true owner, with Sinclair's knowledge of the fraud by which the lease was obtained. (R. 336.)

The true legal interpretation of the Wyoming decision was stated by counsel in the Delaware case, in their report to Congress with respect to the settlement of that suit. They stated: (R. 251, 340, 341.)

> "'This suit was for the conversion of the oil by the Sinclair Crude Oil Purchasing Co. based upon the theory that *as the Mammoth Oil Co. had never acquired a valid title to the leasehold it could not give good title to the oil taken therefrom.*'" (Italics ours.)

The clear implication of the foregoing quotation is that the Delaware suit was actually in no way based upon considerations of fraud or bad faith. This interpretation was adopted by the Congress. The Seventh Circuit adopted a different interpretation in the instant case. *We submit this Court should interpret its own decision and resolve this conflict.*

4. Even under the facts assumed by the lower court, the interest portion of the judgment is clearly allowable under the Commissioner's recently announced policy.

The refusal of the Board and the Court to allow as a deduction the interest portion of the judgment in question is in conflict with the Board's own decision in *Max Thomas Davis,* 46 B. T. A. 663. In that case the Board allowed as a deduction from income amounts paid as interest to the Federal Government upon compromise of civil and criminal liability resulting from willful evasion of Federal taxes. The taxpayer in that case pleaded guilty to both the civil and criminal liability. The deduction was allowed under Section 23(b) of the Revenue Act of 1936, which is identical with the Statute herein involved. The Commissioner has acquiesced in this decision. (Internal Revenue Bulletin No. 25, June 22, 1942, p. 1.)

In this case a substantial portion of the judgment, to-wit: $908,893.06, represented and was admitted by the parties to be interest. (R. 134, 249.) Under the Board decision in the *Max Thomas Davis* case, *supra,* this amount was deductible regardless of the character of the principal payment.

This point cannot be disposed of by saying that the interest in this case represents damages and not interest under the Statute, because this Court has granted a petition in *Commr.* v. *Kieselbach,* 127 F. (2d) 359 (C. C. A. 3) to determine the character of a payment made as interest on a condemnation award where the contention is made that the payment represented damages and not interest under the Statute.

The Court will be called upon to define interest, and its definition will be applicable in this case. This we submit requires the granting of the writ.

5. The lower court's decision is also in conflict in principle with other decisions.

The Court's decision is in conflict in principle with the following decisions: *U. S.* v. *Dominion Oil Co.*, 241 F. 425, 427; *U. S.* v. *Stinson*, 197 U. S. 200, 205, 49 L. ed. 724, 725; *Mountain Copper Co.* v. *U. S.*, 142 F. 625, 629; *In re Minot Auto Co.*, 298 F. 853, 857; *S. M. 4078*, (1926) C. B. V-1, p. 226; *Helvering* v. *Hampton*, (C. C. A. 9) 79 F. (2d) 358, 359, 360; *W. R. Hervey*, 25 B. T. A. 1282, 1290, 1291.

In the last two of the above-cited cases judgments in tort actions were allowed as deductions, even though fraud and bad faith were clearly involved.

The Court below seemed to recognize this general principle because it found it necessary to imply that Stanolind had also violated some criminal statute. The Court said:

> "* * * we think it tolerably safe to say that torts which are committed against the Government and which are *also violative of the criminal statutes* may not furnish the basis of deduction." (Italics ours).

Granted the correctness of the rule, it is not applicable here because Stanolind violated no criminal statute. It was not even charged with "criminal misconduct" in either the Wyoming or Delaware cases or in any other case.

6. The court below also erred in the following respects.

(a) The Circuit Court of Appeals instead of limiting its review to ascertaining whether there was evidence to support the Board's findings and decision made an independent determination based upon alleged facts and inferences drawn from without the record. This it cannot do. *Helvering* v. *National Grocery Co.*, 304 U. S. 282, 82 L. ed. 1346. The Circuit Court is without power to make findings or determinations of fact. *Helvering* v. *Rankin, supra.*

The Court in its opinion states that it can completely eliminate from consideration the evidence which the two

judgments and pleadings and findings in the Wyoming and Delaware suits afford and still find evidence of Stanolind's guilt. The alleged facts which the Circuit Court determined from without the record are: (R. 403.)

> "* * * That Sinclair bribed the Secretary of Interior in order to obtain the Teapot Dome lease is established. The lessee thereupon turned over this lease to his wholly-owned subsidiary, the Mammoth Company. It, Mammoth, was financially irresponsible, having been organized by Sinclair, the corrupter of Secretary Fall. Its entire capital stock of a thousand dollars was issued to Sinclair for services in procuring the oil and gas lease from the United States Government. Sinclair transferred this stock in Mammoth to the Sinclair Consolidated Oil Company.
>
> "Stanolind was owned, half by Sinclair Cons. Oil Co., and half by petitioner. Thus did ownership of both companies stand when Stanolind entered into its contract with Mammoth to purchase the illegally obtained oil drawn from the Teapot Dome property. In other words, Mammoth was Sinclair. It was clearly chargeable with knowledge of Sinclair's criminal action in corruptly obtaining the Teapot Dome lease.
>
> "Sinclair also owned half of Stanolind, and Stanolind, after Sinclair had acquired half of its stock, purchased the oil obtained through the fraudulently executed lease of the Teapot Dome property. * * *"

The "bribery" element seems to be the principal one upon which the Court rests, for it asks the following question which it implies is self-answering and applicable to Stanolind: (R. 403)

> "May one who, through bribery, secures a lease from the Government, which he turns over to a company owned by himself, avoid liability arising out of his criminal misconduct and demand protection on the theory that the corporation created by him to carry out the object of his criminal enterprise, had no knowledge of the fraud or corruption?"

There is no evidence in this record which establishes the alleged bribery, even with respect to Sinclair or Mammoth, much less Stanolind. Certainly it was not established in the Wyoming case where the Supreme Court in its opinion said: (275 U. S. 53)

> "The complaint did not allege bribery, and, in the view we take of the case, there is no occasion to consider and we do not determine whether Fall was bribed in respect of the lease or agreement."

Harry Sinclair never owned any of Stanolind's stock. He was never an officer, director or employee of Stanolind. Mammoth was Harry Sinclair but Stanolind was not. Stanolind was 50 per cent petitioner and 50 per cent Sinclair Consolidated Oil Corporation, a corporation whose stock was widely dealt in on the New York Stock Exchange. Neither petitioner nor Sinclair Consolidated Oil Corporation was a party to the Wyoming litigation nor charged with being a party to the fraud.

The Court goes on to say: (R. 403)

> "Moreover, it would overtax credulity to assume, under the circumstances, that petitioner was an innocent party, unaware of what was going on at a time when Senators in the Senate and the press were charging corruption and demanding an investigation of the conditions under which the Teapot Dome lease was negotiated."

We are indeed in startling times if the Federal Courts can make such grave determinations upon the basis of assumed facts taken from the newspapers.

(b) The Court obviously confused Stanolind with Mammoth. The Court, in its opinion, says: (R. 402)

> "* * * But, uncertain and indistinct as the line may be, we have found no case which permits a taxpayer to successfully claim a deduction based on a sum which said taxpayer has paid the Government by way of dam-

ages which arose from a fraudulent transaction which the said taxpayer perpetrated upon the Government.

"And it is apparent that the case against the allowance of deductions is strengthened, if the facts warrant a finding that the taxpayer made payment to the Government, not alone because of fraud, but because of criminal corruption, to-wit, bribery."

These statements (except for the bribery part) might have applied to Mammoth if it had made the payment and then claimed the deduction. It cannot apply to Stanolind. Stanolind did not make any payment because of fraud or bribery. It paid because it had purchased oil to which the seller had no title. Against that payment it was allowed an equitable offset for its storage tanks to the extent to which the United States had been unjustly enriched. The existence of either fraud or bribery would have precluded such allowance.

(c) The Court's conclusion is based upon the declaration in the Delaware case, not the final result of that litigation. The Court says: (R. 401)

"The complaint in the suit against Stanolind charged it, jointly with Mammoth, with the fraud and corruption by which Mammoth obtained possession of the oil. On such pleading, Stanolind consented to the entry of the judgment in question."

The alleged fraud and corruption by which Mammoth obtained possession of the oil were charged only in the second and third counts of the declaration in the Delaware case. These charges could serve no possible purpose in the trover action except as they might constitute a basis for exemplary or punitive damages. These allegations are not found in the first count which sought merely the value of the oil. Stanolind consented to a judgment upon the basis of the first count only, not the second or the third count. Moreover, the final result also recognized Stanolind's equitable

right to an offset for its storage tanks on the Teapot Dome lease.[1]

CONCLUSION.

It is, therefore, respectfully submitted that this case is one calling for the exercise by this Court of its supervisory powers in order that the errors herein pointed out may be corrected, and that the decree of the United States Circuit Court of Appeals for the Seventh Circuit be reversed.

Respectfully submitted,

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[1] For answer to the Court's suggestion that the allowance for the tanks may have represented a trade for 7 per cent instead of 6 per cent interest, see petition for rehearing (R. 412-414).

APPENDIX.

Section 23 (a)(b)(f) and (j) of the Revenue Act of 1928 provide as follows:

"SEC. 23. DEDUCTIONS FROM GROSS INCOME.

"In computing net income there shall be allowed as deductions:

"(a) *Expenses.*—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; traveling expenses (including the entire amount expended for meals and lodging) while away from home in the pursuit of a trade or business; and rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity.

"(b) *Interest.*—All interest paid or accrued within the taxable year on indebtedness, except on indebtedness incurred or continued to purchase or carry obligations or securities (other than obligations of the United States issued after September 24, 1917, and originally subscribed for by the taxpayer) the interest upon which is wholly exempt from taxation under this title.

* * * * * * * * *

"(f) *Losses by corporations.*—In the case of a corporation, losses sustained during the taxable year and not compensated for by insurance or otherwise.

* * * * * * * * *

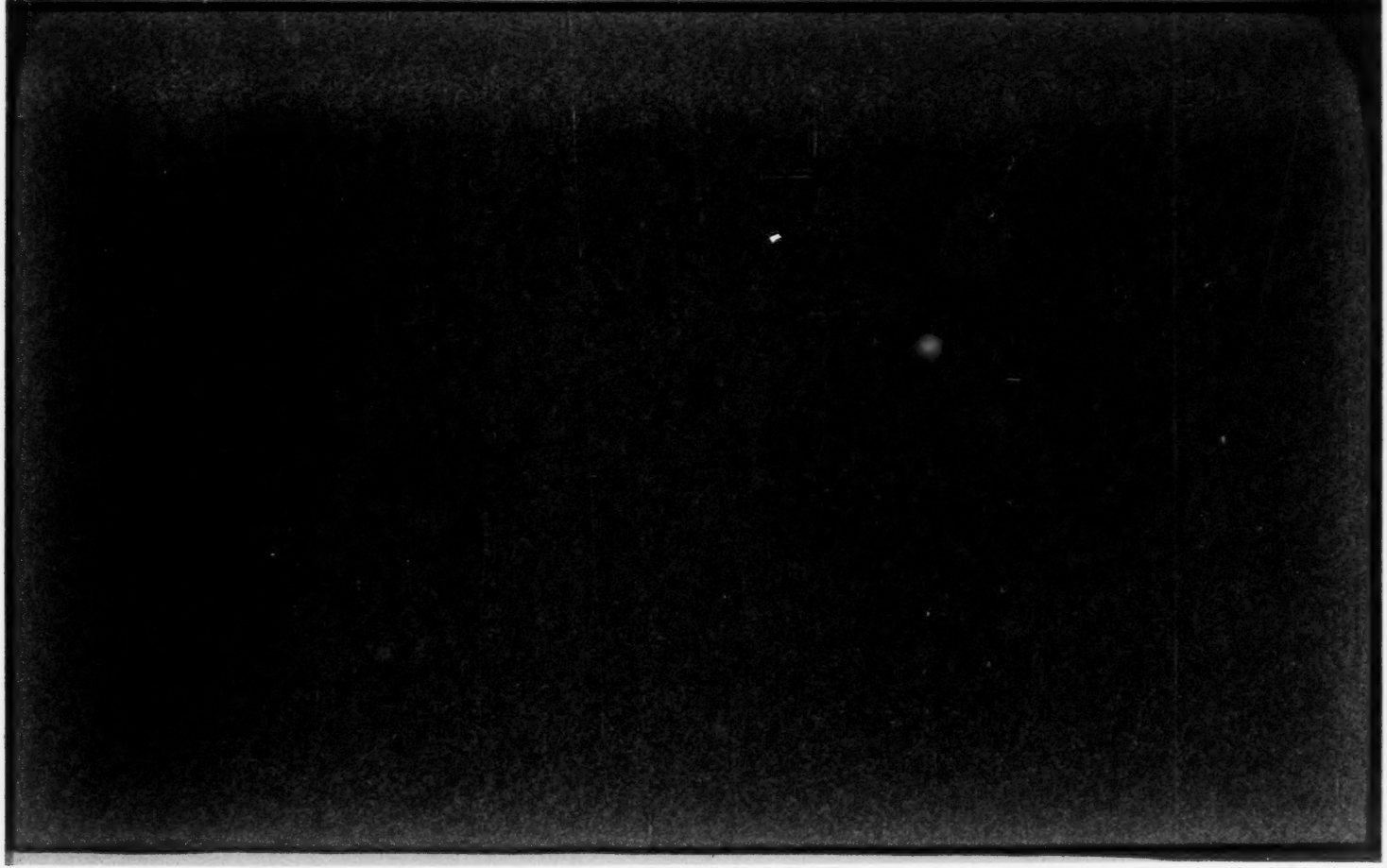
"(j) *Bad debts.*—Debts ascertained to be worthless and charged off within the taxable year (or, in the discretion of the Commissioner a reasonable addition to a reserve for bad debts); and when satisfied that a debt is recoverable only in part, the Commissioner may allow such debt to be charged off in part."

Article 342 of Regulations 74 provides in part as follows:

"ART. 342. *When charges deductible.*

* * * * * * * * *

"* * * Judgments or other binding adjudications, such as decisions of referees and boards of review under workmen's compensation laws, on account of damages for patent infringement, personal injuries, or other cause, are deductible from gross income when the claim is so adjudicated or paid, unless taken under other methods of accounting which clearly reflect the correct deduction, less any amount of such damages as may have been compensated for by insurance or otherwise. * * *".



INDEX

CITATIONS

495960 42——1

In the Supreme Court of the United States

OCTOBER TERM, 1942

No. 512

STANDARD OIL COMPANY (AND AFFILIATED SUBSIDIARIES), PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 319–361) is reported in 43 B. T. A. 973. The opinion of the Circuit Court of Appeals (R. 391–408) is reported in 129 F. 2d 363.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered June 12, 1942. (R. 408.) A petition for rehearing was denied August 5, 1942.

(R. 418.) The petition for a writ of certiorari was filed November 4, 1942, and the jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the taxpayer was properly denied any deduction under Section 23 of the Revenue Act of 1928 for the sum paid the United States in settlement of a suit based on the conversion of oil acquired from the lessee of the Teapot Dome.

STATUTE AND REGULATIONS INVOLVED

The applicable statute and regulations are set forth in the Appendix, *infra,* pp. 21–23.

STATEMENT

The facts found by the Board of Tax Appeals may be summarized, as follows:

During the calendar year 1930, the taxpayer was the "common parent corporation" of an "affiliated group" under Section 141 of the Revenue Act of 1928 and Article 2 of Treasury Regulations 75, issued pursuant thereto. (R. 321, 322.) On September 22, 1930, the taxpayer acquired all of the stock of the Stanolind Crude Oil Purchasing Company (referred to herein as Stanolind), which thus became one of the affiliated group. (R. 326.) Stanolind filed a separate return for the period January 1 to September 21, 1930, showing a substantial net loss, produced mainly by the

deduction here in issue. The taxpayer has claimed a carry-over of this net loss under Section 117 (a) of the Act (Appendix, *infra*). (R. 345–346.)

Stanolind was incorporated on February 5, 1921 (R. 321), and was known until September 22, 1930, as the Sinclair Crude Oil Purchasing Company (R. 321, 327). During this period half of Stanolind's stock was owned by the Sinclair Consolidated Oil Company and half by the taxpayer. (R. 326.) The chairman of the board of directors of Sinclair Consolidated Oil Company was Harry F. Sinclair. (R. 332.)

On February 28, 1922, Sinclair incorporated the Mammoth Oil Company. Its stock was issued to him for $1,000 and his services in procuring for Mammoth on or about April 7, 1922, what purported to be an oil and gas lease for Mammoth from the United States on certain Government-owned lands in the State of Wyoming known as Naval Petroleum Reserve No. 3 and commonly called "Teapot Dome." Shortly thereafter Sinclair Consolidated Oil Company acquired the stock of Mammoth. (R. 326.)

The lease was signed on behalf of the United States by Albert B. Fall, then Secretary of the Interior, and Edwin Denby, then Secretary of the Navy. It was signed on behalf of Mammoth by H. F. Sinclair, president. It purported to grant Mammoth the exclusive right to take and dispose

of the oil and gas from the land covered so long as it was produced in paying quantities. It also purported to give Mammoth the right to construct tanks and other operating facilities on the leased lands. (R. 327.)

On February 9, 1923, the same parties entered into what purported to be a supplemental agreement concerning, among other things, certain storage facilities to be provided by Mammoth, the operation of the purported lease, and the disposal of the Government's royalty oil. Stanolind was not a party either to the lease or supplemental agreement, and it was not mentioned in either instrument. (R. 327.)

On October 24, 1922, Stanolind entered into a three-party contract with Mammoth and another subsidiary of the taxpayer. The agreement recited, *inter alia,* that the parties desired to cooperate in a program to extend the market for crude oil produced in the State of Wyoming; and that Mammoth owned and operated the lease on Naval Reserve No. 3, commonly called "Teapot Dome." Under the agreement, Stanolind agreed to purchase the first oil to be produced by Mammoth from the Teapot Dome to an amount not exceeding 30,000,000 barrels. (R. 327–330.)

On March 13, 1924, the United States instituted an action in the District Court of the United States for the District of Wyoming to cancel the Teapot Dome lease and set aside the supple-

mental agreement. Stanolind was named as one of the parties defendant. The complaint alleged that Stanolind claimed to hold certain rights derived from defendant Mammoth Oil Company and maintained certain oil storage tanks on the land covered by the lease in question. The bill prayed for an adjudication of the rights of the defendants in the premises and a decree against Stanolind in relief of the plaintiff's right of possession. (R. 332–333.) In its answer Stanolind denied that it was a trespasser and "for separate and further defense" alleged such facts as it thought necessary to establish its ownership in and right to remove the 17 tanks located on the Teapot Dome lease. (R. 334.)

On the day the bill of complaint was filed, receivers were appointed for the property covered by the lease, excluding the oil storage tanks owned by Stanolind. Prior to the receivership, Stanolind, pursuant to its contract with Mammoth, obtained 1,430,024.70 barrels of oil from lands covered by the Teapot Dome lease. For this oil it paid Mammoth the sum of $2,167.591.26. (R. 330, 333.)

On June 19, 1925, the District Court handed down its decision in the Wyoming suit, *United States* v. *Mammoth Oil Co.*, 5 F. 2d 330, upholding the validity of the lease. The District Court's decision was reversed and remanded by the Circuit Court of Appeals for the Eighth Cir-

cuit on September 28, 1926. 14 F. 2d 705. The Circuit Court of Appeals found that "each of the appellees is a *mala fide* trespasser" and held that the lease and agreement were obtained by fraud and corruption. It directed the District Court to cancel the lease, enjoin the defendants from further trespassing on the land involved and require an accounting on the part of the Mammoth Oil Company for all oil taken under the lease. (R. 334.)

The opinion of the Circuit Court of Appeals was affirmed by the Supreme Court on October 10, 1927. *Mammoth Oil Co.* v. *United States,* 275 U. S. 13, 55. The Supreme Court held not only that the execution of the lease and agreement was fraudulent, but also that there was no authority in law for their execution. In adjudicating the rights of Stanolind in the premises, the Court said (pp. 53–54, 55):

> The lease gave the Mammoth Company the right to construct tanks and other operating facilities on the reserve. In January, 1923, the petitioner, Sinclair Crude Oil Purchasing Company [Stanolind], bought from that company the tanks already constructed and others being built thereon. It used them to store Salt Creek royalty oil that it bought from the Government. It claims that it relied on the validity of the lease and became the owner of the tanks as licensee and grantee of the lessee and entitled to maintain them in all respects as

the lessee was entitled to do under the lease. It contends that the Circuit Court of Appeals erred in directing it to be restrained from further trespassing upon the reserve, and that in any event it should be given opportunity to remove its property. But the Purchasing Company is presumed to have known that no law authorized the making of any such lease. The existence of that arrangement for the exhaustion of the reserve was calculated to excite the apprehensions of one considering such a purchase and put him on his guard rather than to give assurance of safety. The use of such tanks to take oil from the reserve was a part of the illegal scheme. Moreover, the Purchasing Company was owned half and half by the Sinclair Consolidated Oil Corporation and the Standard Oil Company of Indiana. Sinclair was chairman of the board of the former, and Stewart held like position in the latter. Shortly before the Purchasing Company bought the tanks, these chairmen acted for and controlled it in respect of most important transactions. That and other disclosed circumstances are sufficient to impute to it Sinclair's knowledge of the conspiracy to defraud by which the lease was obtained. It is clear that, in respect of the use and removal of these tanks, the Purchasing Company is in no better position than the Mammoth Company would have occupied, if it owned them.

* * * * *

195960—42—2

> The tanks, pipe line and other improvements put upon the reserve for the purpose of taking away its products were not authorized by Congress. The lease and supplemental agreement were fraudulently made to circumvent the law and to defeat public policy. No equity arises in favor of the lessee or the other petitioners to prevent or condition the granting of the relief directed by the Circuit Court of Appeals. Petitioners are bound to restore title and possession of the reserve to the United States, and must abide the judgment of Congress as to the use or removal of the improvements or other relief claimed by them. *Pan American* case, *supra*, p. 510.

Pursuant to the mandate from the Supreme Court the District Court on December 29, 1927, entered a decree enjoining the defendants from trespassing on the land and from claiming any right, title, or interest to any improvements thereon or from removing any of the improvements. In the final decree in the Wyoming suit Mammoth was ordered to pay the United States the sum of $2,294,597.74 as the value of oil and other petroleum taken together with interest thereon of seven per cent. Only $3,509.19 was paid on this judgment. (R. 336.)

Thereafter the United States brought an action against Stanolind in the United States District Court for the District of Delaware for the conversion of the 1,430,024.70 barrels of crude oil

which Stanolind had obtained from Mammoth under the contract of October 24, 1922. (R. 336.) In addition to the value of the oil and seven per cent interest thereon the declaration in the Delaware suit claimed exemplary and punitive damages on the ground that Stanolind had acquired the oil fraudulently. (R. 338.)

After the pleadings were in, Stanolind offered to terminate the case by paying the sum of $2,906,484.32. This figure represented the value of the oil plus interest at seven per cent, less the estimated value of the 17 oil tanks erected by Stanolind on the Teapot Dome land. Owen J. Roberts and Atlee Pomerene, special counsel for the United States, recommended approval of this settlement to Congress and it was thereafter approved by a joint resolution. (R. 339, 340–344.) Subsequently upon stipulation filed by counsel for the United States and Stanolind judgment for the amount of the settlement was entered in the case. The judgment was paid by Stanolind on June 2, 1930, from funds previously placed in escrow. (R. 344.)

At the time of the judgment, Stanolind's books carried an account payable to Mammoth in the amount of $4,618.86. This amount was credited to surplus, and the amount of $2,906,484.32 was charged to surplus. The effect was a net charge to surplus of $2,901,865.46. (R. 344–345.)

Stanolind filed a separate return for the period January 1 to September 21, 1930, on which it

reported a net loss of $3,715,123.57. In arriving at this net loss, it deducted the aforesaid figure of $2,901,865.46. (R. 345.) This net loss was carried over in the consolidated return.

In disallowing a deduction for any part of this payment, the Board of Tax Appeals found (R. 346):

> 44. The lease of April 7, 1922, and the supplemental agreement of February 9, 1923, were executed without warrant or authority of law and contrary to the policy of the United States to conserve its petroleum resources. The lease and agreement were fraudulent. Stanolind is charged with notice that those agreements were executed contrary to law, and with knowledge of the fraud perpetrated. Stanolind acted in bad faith and as a *mala fide* trespasser upon the Government-owned lands in acquiring the 1,430,024.70 barrels of oil in question.

The Board based this finding on the conclusion that the Wyoming action was *res judicata* of Stanolind's bad faith.

The Board held that in light of this finding it would be against public policy to allow any deduction. (R. 360.) It was found unnecessary to determine whether the payment otherwise might be designated as an expense, a loss, or a bad debt, or in part as interest on indebtedness, under the statutory provisions for deductions contained in Subsections (a), (b), (f), or (j) of Section 23 of the Revenue Act of 1928 (Appendix, *infra*).

The Circuit Court of Appeals sustained the Board on both grounds of its decision.[1] The court concluded (1) that the Board's finding of bad faith was supported both by the prior decision in the Wyoming case (R. 398–399) and by the inferences otherwise to be drawn from the record (R. 402–405), and (2) that public policy therefore properly forbade the allowance of any deduction (R. 402).[2]

ARGUMENT

I

The circuit courts of appeals have consistently disallowed any deductions for fines or penalties paid by a taxpayer as a consequence of statutory

[1] There was a second issue in the case concerning the depreciation of patents held by the taxpayer upon which review has not been sought.

[2] The court also expressed the view that, while it was unnecessary to consider the question, any claim which Stanolind might have had against Mammoth for breach of warranty did not provide a basis for a bad debt deduction (R. 400), but that if a deduction was allowable, it would fall under the heading of a bad debt, rather than of an ordinary and necessary business expense or a loss (R. 402). Like the Board, the court did not consider whether, if it were not for the public policy consideration, the portion of the payment representing interest would be deductible as interest on indebtedness under Section 23 (b).

Neither the Board nor the court passed on the Government's further contention that if the deduction was allowable, it could not be carried over as part of the net loss under Section 117(a)(1) since it was not "attributable to the operation of a trade or business regularly carried on by the taxpayer".

violations. *Burroughs Bldg. Material Co.* v. *Commissioner,* 47 F. 2d 178 (C. C. A. 2d) (violation of state price-fixing laws); *Great Northern Ry Co.* v. *Commissioner,* 40 F. 2d 372 (C. C. A. 8th), certiorari denied, 282 U. S. 855 (violation of federal statute and regulations in operation of railroad); *Chicago, R. I. & P. Ry. Co.* v. *Commissioner,* 47 F. 2d 990 (C. C. A. 7th), certiorari denied on other points, 284 U. S. 618 (violation of Safety Appliance Act); *Tunnel R. R.* v. *Commissioner,* 61 F. 2d 166, 173–174 (C. C. A. 8th), certiorari denied, 288 U. S. 604 (violations of Safety Appliance Act and the Twenty-Eight Hour Live Stock Act)[3]; cf. *National Outdoor Advertising Bureau* v. *Helvering,* 89 F. 2d 878 (C. C. A. 2d); *Gould Paper Co.* v. *Commissioner,* 72 F. 2d 698 (C. C. A. 2d). The decision below applies the same rule respecting compensation paid the Government by a taxpayer who, it was found, converted public property to its own use in circumstances constituting bad faith.

The controlling consideration in the cases cited is that the taxpayer had engaged in a course of conduct which constituted a wrong against the Government, for which it had been compelled to make compensation. The courts have taken the view that it would be against public policy indirectly to

[3] The English courts have reached similar results in applying the cognate provisions of the British Income Tax Acts. See *Inland Revenue Commissioners* v. *Von Glehn,* [1920] 2 K. B. 553; *Inland Revenue Commissioners* v. *Warnes & Co.,* [1919] 2 K. B. 444.

sanction the violation by allowing a tax deduction for the amount of the fine or penalty imposed. *Burroughs Bldg. Material Co.* v. *Commissioner, supra,* p. 180. It would be outside the reasonable intention of the Congress to allow the taxpayer "any advantage, directly or indirectly, or any reduction, directly or indirectly, of these penalties." *Great Northern Ry. Co.* v. *Commissioner, supra,* p. 373.

In the instant case, the ultimate question is the same, and the same considerations apply with even greater force. Stanolind acted directly to the injury of the Government. It entered into the agreement with Mammoth in bad faith, charged with notice that Mammoth's lease from the Government was executed contrary to law and with knowledge of the fraud perpetrated. It participated in a violation of the established policy of the Government for the conservation of naval oil, fraudulently converting to its own use property thus held for the benefit of the public. It would be as violative of public policy indirectly to sanction such conduct by allowance of a deduction for the payment made in restitution to the Government, as it would be to allow a deduction for fines paid for the violation of regulatory statutes. Congress did not intend that a taxpayer, which had been compelled in such circumstances to compensate the Government for conversion of its property, should be enabled, through abatement of

its taxes, to recover a portion of the funds paid.[4]

Moreover, at the last Term the Court sustained the validity of regulations providing that lobbying expenses were not deductible as "ordinary and necessary" expenditures. *Textile Mills Corp.* v. *Commissioner,* 314 U. S. 326. The Court held that the rule-making authority might employ the general policy against lobbying activity in segregating non-deductible expenses. Similarly, we submit, comparable policy considerations may properly be taken into account by the Commissioner, the Board of Tax Appeals, and the courts in determining the scope of the statutory deductions.

The decision on this point, therefore, is in accord with the decided cases. The Court, as we have noted, has denied certiorari on the question as it was presented in the *Great Northern* and *Tunnel* cases, *supra.* No conflict has since arisen.[5] We submit that no occasion now exists for a review of the question upon the peculiar facts of the instant case.

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[4] It should be observed, moreover, that these considerations would support the decision below even in the absence of a finding of bad faith. All of the cases, which we have cited, concerned violations of mere regulatory provisions; none involved any element of bad faith.

[5] There is clearly no inconsistency, as the taxpayer asserts (Pet. 18), between this decision and the allowance of a deduction for payments made in satisfaction of a private judgment. Treasury Regulations 75, Article 342; *Helvering* v. *Hampton,* 79 F. 2d 358 (C. C. A. 9th). The court in the *Hampton* case observed the distinction "between the defense

II

There is likewise no occasion for review of the action of the court below in sustaining the Board's finding that Stanolind acted in bad faith.[6] (See Statement, *supra*.) The decision was correct, and there is no conflict. Resolution of the issue presented, whether it be regarded as one of fact or

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of offenses *against the government*, of which governmental policy prohibits consideration as ordinary incidents of a business, and defending *private wrongdoing* in the course of business, the cost of which is ruled deductible" (p. 360).

The taxpayer also asserts a conflict with a number of cases, most of which simply support the general proposition that when the Government enters the courts as a litigant, it is subject to many of the rules governing private individuals. (Pet. 18.) The proposition, however, is obviously beside the point. Significant, rather, is the fact that in *Pan American Co.* v. *United States*, 273 U. S. 456, 508–509, sustaining cancellation of the lease of the California reserves companion to the Teapot Dome lease, the Court emphasized that in this type of action the United States did not stand on the same footing as an individual.

[6] As we have indicated, the Government also argued below that irrespective of the public policy issue and the finding of bad faith, the taxpayer had not established Stanolind's right to a deduction under any one of the statutory provisions involved, namely, Subsections (a), (b), (f) or (j) of Section 23 of the Revenue Act of 1928. It was further argued that in any event the deduction sought could not properly be carried over as part of a net loss under Section 117 (a) of the Act. It is unnecessary to elaborate upon these arguments here. The questions would be before the Court, however, if certiorari were granted.

By the same token, there is likewise no need to consider in detail the taxpayer's contention that the Government's position is inconsistent with the Commissioner's acquiescence in *Davis* v. *Commissioner*, 46 B. T. A. 663, permitting a de-

one of mixed fact and law, turned solely upon the peculiar facts of the instant case.

1. The Board's finding, as we have stated, was based upon its conclusion that the Wyoming action was *res judicata* of the issue. Since the actions were between the same parties (see *Sunshine Coal Co.* v. *Adkins,* 310 U. S. 381, 402–403), the question is whether the prior proceeding included a determination that Stanolind had acted in bad faith and as a *mala fide* trespasser.

In the Wyoming case Stanolind, as a defendant, asserted that even if Mammoth's lease from the Government was invalid, Stanolind was entitled as a third party purchaser to continue its oil storage tanks upon the property and in the alternative to remove them. (R. 212–214, 272–273, 283–284.) Its position was dependent upon its good faith. But in reversing the District Court's judg-

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duction as interest paid on an indebtedness for that portion of a settlement of a tax liability, including principal, penalty and interest, which consisted of interest. (Pet. 17.) The issue in that case was whether the interest payment was separable interest or part of a lump sum compromise. Since the taxes, exclusive of penalties, would have been payable irrespective of the taxpayer's wrong-doing, the interest to that extent did not result from the taxpayer wrong-doing. To the extent the interest may have been computed on the penalties it is significant that Section 294 (b) of the Revenue Act of 1936 provides that "there shall be collected as part of the tax, *interest* upon the unpaid amount [including fraud penalties] at the rate of 6 per centum per annum." (Italics supplied.) While the question is not free from doubt, this may indicate a congressional intention that interest on fraud penalties is to be treated as interest generally.

ment for the defendants, the Circuit Court of Appeals held that Stanolind was a *mala fide* trespasser on the Government lands, and that therefore it was entitled to no protection for its improvements; it directed the District Court to enjoin the defendants from trespassing on the land. *United States* v. *Mammoth Oil Co., supra,* 14 F. 2d, at 733.

In the proceedings before this Court, Stanolind specified as errors the Circuit Court of Appeals' holding that it was a trespasser *mala fide* on the land, and denial of its right to remove the oil storage tanks which "it had in good faith purchased and constructed thereon." (R. 290.) This Court sustained the Circuit Court of Appeals, holding, in an opinion of which the relevant portions have been quoted in the Statement, *supra,* pp. 6–8, that Stanolind was presumed to know that Mammoth's lease was unauthorized, and that the facts were sufficient to impute to it Sinclair's knowledge of the conspiracy to defraud. 275 U. S. 13, 54.

2. The taxpayer's contention that this decision was not *res judicata* as to Stanolind's bad faith because the litigation concerned the *tanks* rather than the *oil* (Pet. 14–16) is an ingenious but unpersuasive refinement. The trespass on the lands, the erection of the tanks, and the taking of the oil, were all integrated parts of the same illegal scheme. The fact that a different *res* is involved does not prevent the application of the doctrine of *res judicata* where the same issue is presented.

Beloit v. *Morgan,* 7 Wall. 619, 622; *Bissell* v. *Spring Valley Township,* 124 U. S. 225; *New Dunderberg Min. Co.* v. *Old,* 97 Fed. 150 (C. C. A. 8th).

The taxpayer also argues that the consent judgment entered in the subsequent Delaware action against Stanolind constituted a determination that Stanolind had not acted in bad faith. (Pet. 11–13.) This judgment, however, was entered pursuant to a settlement, proposed and effected after Stanolind's bad faith had been adjudicated in the Wyoming action. In this settlement, each side made concessions in order to terminate the litigation. The District Court's judgment, entered upon this settlement, was not a judicial *determination* that Stanolind had acted in good faith. And there is no sound basis for a conclusion that the Government, by agreeing to the compromise, otherwise committed itself to any such proposition binding upon it here.

3. There is also ample evidence to support the Board's determination of bad faith aside from the decision in the Wyoming case. The relationship between Stanolind, Sinclair, and Mammoth, which appears of record, was observed by this Court in the Wyoming opinion. Even apart from this, the sequence of events in the development of the Teapot Dome scandal alone shows the impossibility of regarding Stanolind as an innocent party.

Considerably prior to Stanolind's execution of the oil purchasing contract with Mammoth, charges had been made publicly that the Teapot

Dome leases were fraudulent and in violation of statutes establishing a long-standing policy for the conservation of the nation's oil resources. *E. g.*, Cong. Record, Vol. 62, Part 6, pp. 6042–6050. On April 29, 1922, six months prior to Stanolind's contract with Mammoth, the Senate of the United States, acting on these charges, adopted a resolution by unanimous vote initiating a formal investigation. S. Res. 282, Cong. Record, Vol. 62, Part 6, p. 6097.[7] On June 3, 1922, Secretary of the Interior Fall's answer to the inquiry of the Senate was sent in. S. Doc. No. 210, 67th Cong., 2d Sess. On June 5, 1922, the resolution authorizing the investigation was implemented by an amendment which, *inter alia,* conferred subpoena powers upon the committee. S. Res. 294, Cong. Record, Vol. 62, Part 8, p. 8140. The matter was given the widest publicity.[8] Four months later and directly in the face of these public charges and the Senate's formal investigation Stanolind entered into its contract with Mammoth for its participation in the exploitation of these resources.

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[7] The resolution authorized the Committee on Public Lands and Surveys (p. 6041):

"* * * to investigate this entire subject of leases upon naval oil reserves, with particular reference to the protection of the rights and equities of the Government of the United States and the preservation of its natural resources, and to report its findings and recommendations to the Senate."

[8] See *e. g.*, N. Y. Times, May 7, 1922, Sec. VII, p. 1; Literary Digest, Vol. 73, No. 8, p. 14 (May 20, 1922); N. Y. Times, August 26, 1922, p. 4, col. 4.

The only conclusion to be drawn from these facts is that Stanolind was at least put upon warning of the invalidity of the lease, and that it must be charged with knowledge of the wrongful character of the transaction. That conclusion has been reached by the Circuit Court of Appeals for the Eighth Circuit and this Court in the Wyoming case, and the court below in the instant case. We submit that further litigation of the issue is uncalled for.

CONCLUSION

The petition for certiorari should be denied.

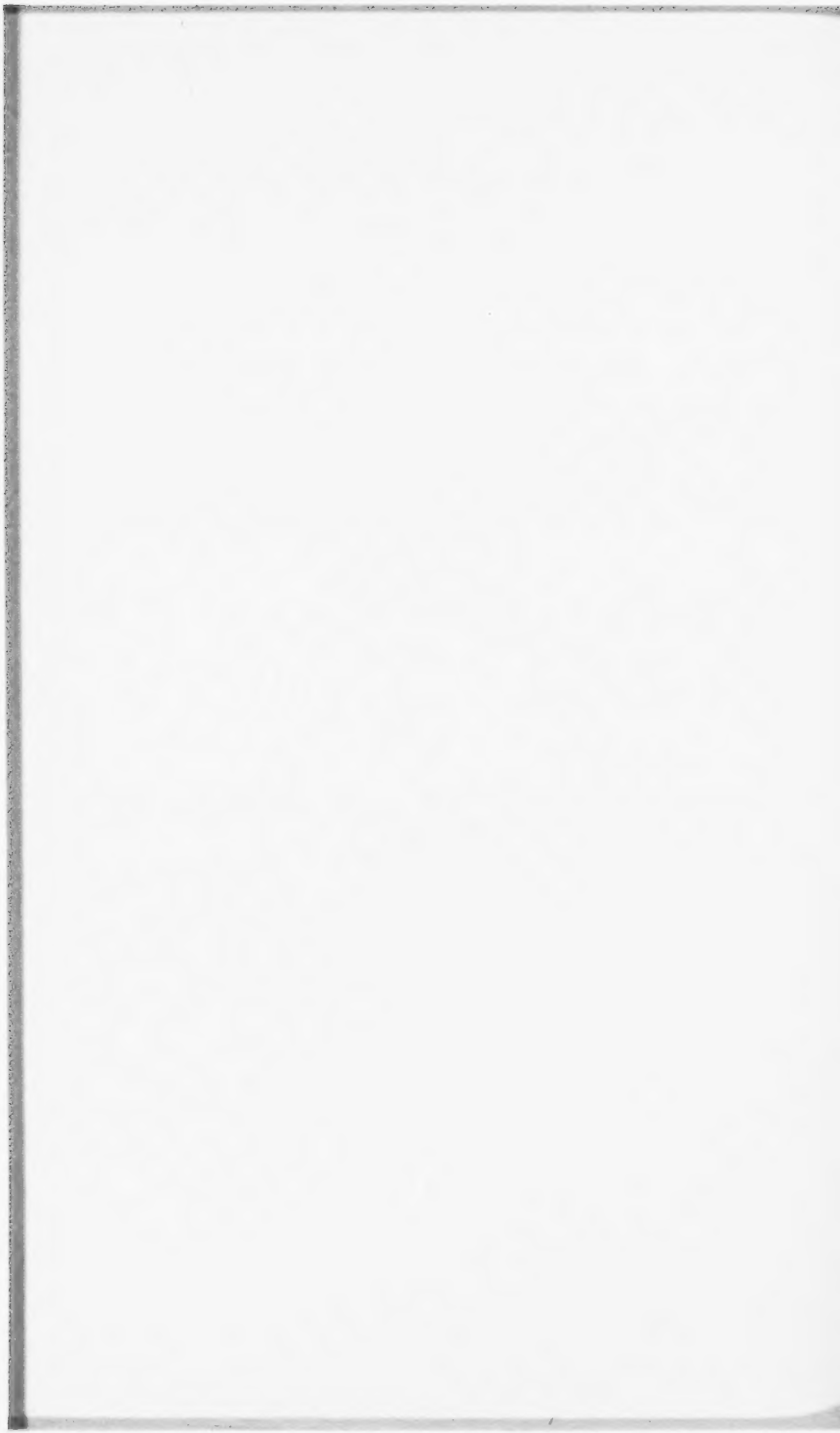
Respectfully submitted,

CHARLES FAHY,
Solicitor General.

SAMUEL O. CLARK, JR.,
Assistant Attorney General.

SEWALL KEY,
SAMUEL H. LEVY,
WILLARD H. PEDRICK,
Special Assistants to the Attorney General.

NOVEMBER, 1942.



APPENDIX

Revenue Act of 1928, c. 852, 45 Stat. 791:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

(a) *Expenses.*—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; traveling expenses (including the entire amount expended for meals and lodging) while away from home in the pursuit of a trade or business; and rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity.

(b) *Interest.*—All interest paid or accrued within the taxable year on indebtedness, except on indebtedness incurred or continued to purchase or carry obligations or securities (other than obligations of the United States issued after September 24, 1917, and originally subscribed for by the taxpayer) the interest upon which is wholly exempt from taxation under this title.

* * * * *

(f) *Losses by corporations.*—In the case of a corporation, losses sustained during the taxable year and not compensated for by insurance or otherwise.

* * * * *

(j) *Bad debts.*—Debts ascertained to be worthless and charged off within the taxable year (or, in the discretion of the Commissioner, a reasonable addition to a reserve for bad debts); and when satisfied that a debt is recoverable only in part, the Commissioner may allow such debt to be charged off in part.

* * * * *

SEC. 117. NET LOSSES.

(a) *Definition of "net loss."*—As used in this section the term "net loss" means the excess of the deductions allowed by this title over the gross income, with the following exceptions and limitations:

(1) *Non-Business Deductions.*—Deductions otherwise allowed by law not attributable to the operation of a trade or business regularly carried on by the taxpayer shall be allowed only to the extent of the amount of the gross income not derived from such trade or business; * * *

* * * * *

Treasury Regulations 75, promulgated under the Revenue Act of 1928:

ART. 41.—*Net Losses.*

* * * * *

(c) *Net Loss Sustained by Separate Corporation Prior to Consolidated Return Period.*

A net loss sustained by a corporation prior to the date upon which its income is included in the consolidated return of an affiliated group (including any net loss sustained prior to the taxable year 1929) shall be allowed as a deduction in computing the consolidated net income of such group in the same manner, to the same extent, and upon the same conditions as if the consoli-

dated income were the income of such corporation; but in no case in which the affiliated status is created after January 1, 1929, will any such net loss be allowed as a deduction in excess of the cost or the aggregate basis of the stock of such corporation owned by the members of the group.

* * * * *

ART. 342. *When charges deductible.*— * * * Judgments or other binding adjudications, such as decisions of referees and boards of review under workmen's compensation laws, on account of damages for patent infringement, personal injuries, or other cause, are deductible from gross income when the claim is so adjudicated or paid, unless taken under other methods of accounting which clearly reflect the correct deduction, less any amount of such damages as may have been compensated for by insurance or otherwise. * * *

U. S. GOVERNMENT PRINTING OFFICE: 1942

IN THE

Supreme Court of the United States

OCTOBER TERM, 1942.

No. 512.

STANDARD OIL COMPANY (INDIANA), *Petitioner,*

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

MOTION FOR LEAVE TO FILE PETITION FOR REHEARING AND PETITION FOR REHEARING.

BUELL F. JONES,
JOHN ENRIETTO,
Counsel for Petitioner.

Of Counsel:
HAMEL, PARK & SAUNDERS,
C. F. ROTHENBURG.

PRESS OF BYRON S. ADAMS, WASHINGTON, D. C.

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COMMISSIONER OF INTERNAL REVENUE, *Respondent*.

MOTION FOR LEAVE TO FILE PETITION FOR REHEARING.

To the Honorable Chief Justice and Associate Justices of the Supreme Court of the United States:

Petitioner, Standard Oil Company (Indiana), respectfully moves that it be granted leave to file the attached petition for rehearing out of time for the following reason:

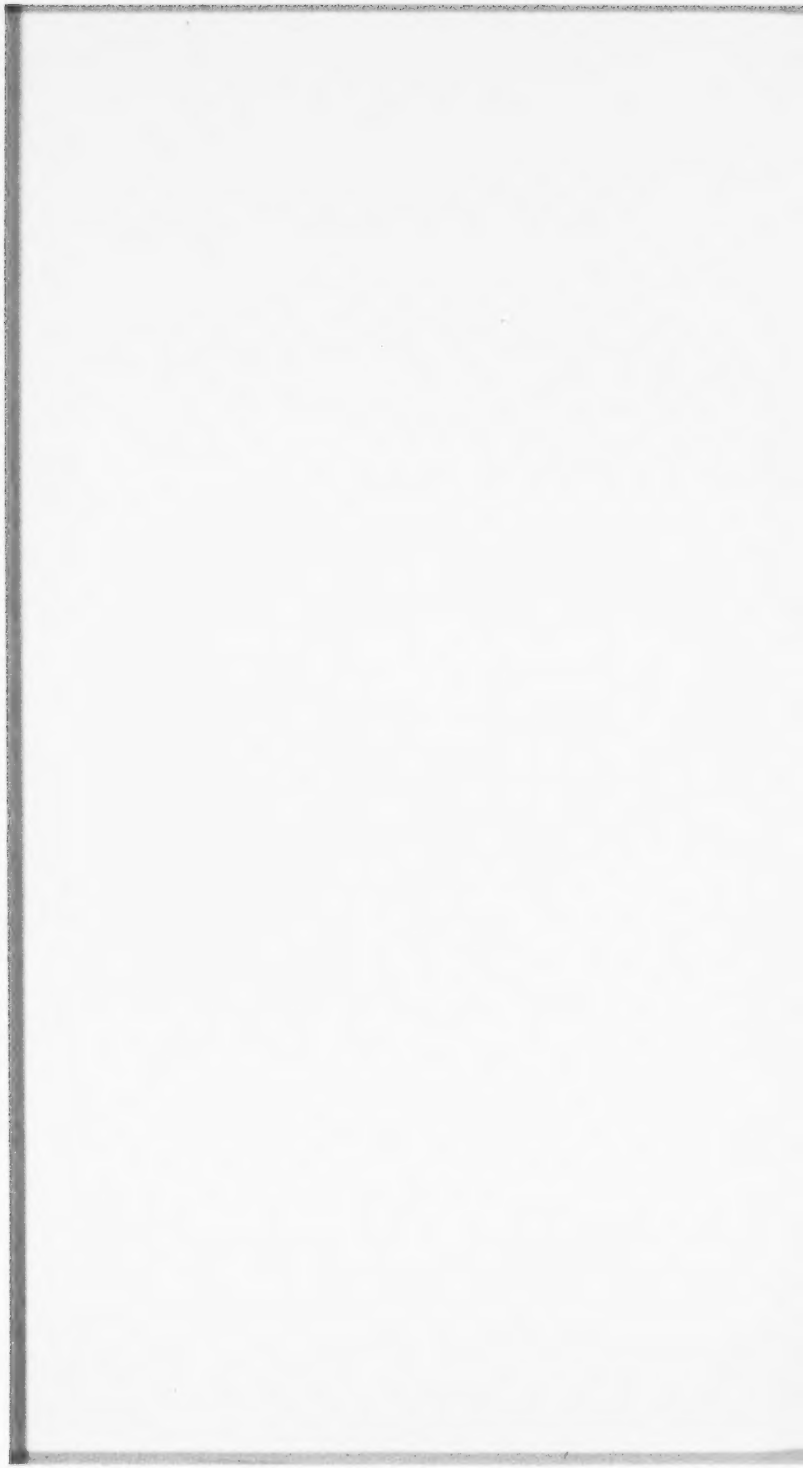
On December 7, 1942, this Court denied petition for writ of certiorari in the above entitled cause directed to a judgment of the United States Circuit Court of Appeals for the Seventh Circuit. Since that time, on February 15, 1943, the same Circuit Court of Appeals entered a decision adverse to respondent in *S. B. Heininger* v. *Commissioner* (133 F. (2d) 567), deciding a question of law which, in all

important respects, is admitted by respondent to be similar to the issues previously presented to this Court by this petitioner's application for writ of certiorari. On May 14, 1943, the Commissioner of Internal Revenue filed a petition for writ of certiorari in this Court directed to the judgment of the Circuit Court of Appeals entered in the *Heininger Case* aforesaid (No. 1027).

Wherefore, petitioner prays that this motion be granted to the end that its petition may be reconsidered by this Court.

Respectfully submitted,

BUELL F. JONES,
JOHN ENRIETTO,
Counsel for Petitioner.



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OCTOBER TERM, 1942.

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STANDARD OIL COMPANY (INDIANA), *Petitioner*,

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*.

PETITION FOR REHEARING.

To the Honorable Chief Justice and Associate Justices of the Supreme Court of the United States:

Petitioner, Standard Oil Company (Indiana), respectfully prays that the judgment of this Court heretofore entered on December 7, 1942, in the above-entitled cause denying petition for writ of certiorari to review the judgment of the Circuit Court of Appeals for the Seventh Circuit be vacated and that the petition for writ of certiorari as prayed for be granted, for the reasons hereinafter stated:

In this case the Circuit Court (opinion by Evans, J.) decided that any income tax deduction in respect of a payment made to the United States of $2,906,484.32 in the year 1930 in settlement of an action in trover on account of oil purchased by an affiliate of petitioner from Mammoth Oil Co. and produced by the latter from invalid Teapot Dome leases

should be denied because of public policy. (R. 402.) That considerations of public policy formed the principal basis for the Court's decision has been specifically admitted by respondent. (Resp. Br. 11.) Petitioner requested review of the decision below specifically assigning as a ground for granting the writ the question whether public policy should be extended to prohibiting the income tax deduction claimed. (Pet. Br. 8, et seq.) This Court denied the petition on December 7, 1942.

In the case of *Heininger* v. *Commissioner*, the same Circuit Court of Appeals was confronted with a demand that public policy be applied to deny income tax deductions to a taxpayer for sums paid in 1937 and 1938 in an unsuccessful defense against issuance of a fraud order by the Postmaster General relating to the taxpayer's business. On February 15, 1943, the Circuit Court (opinion by Minton, J.) specifically held that "public policy" did not operate to prohibit the deduction claimed. (133 F. (2d) 567.)

On May 15, 1943, the Government filed in this Court a petition for writ of certiorari (*Helvering, Com'r* v. *Heininger*, Docket No. 1027) not only claiming that the decision of the Seventh Circuit Court was in conflict with the decision of the Second Circuit in *National Outdoor Advertising Bureau* v. *Helvering*, 89 F. (2d) 878, but also specifically claiming that it was contrary to the application of public policy in this taxpayer's case. (See petition in No. 1027, p. 6.)

It is respectfully submitted that the principles of public policy involved in the *Heininger Case* and in the taxpayer's case are substantially the same and that if certiorari is granted in the former case it ought also to be granted in the instant case.

The previous denial of a writ in this case occurred during the present term and the Court therefore has full power to set aside the denial. The provisions of I. R. C. Sec. 1140(c) specifying the date when a Board decision becomes final is subject to the general power of this Court to vacate

its order denying the petition, if such action seems appropriate. In other words, the denial of certiorari does not become final so long as the Court has power to set it aside. *Helvering* v. *Northern Coal Co.*, 293 U. S. 191, 79 L. ed. 281, holds nothing to the contrary for that was an application for rehearing made more than the fixed statutory period of thirty days after mandate of affirmance had been issued by this Court and this Court simply considered that its power to recall the mandate had been withdrawn upon expiration of the statutory thirty days.

Wherefore it is prayed that this petition be granted and that the petition for writ of certiorari be reconsidered and allowed.

Respecfully submitted,

BUELL F. JONES,
JOHN ENRIETTO,
Counsel for Petitioner.

Of Counsel:
HAMEL, PARK & SAUNDERS,
C. F. ROTHENBURG.